FILE COPY

FILED
JUL 20 1945
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 142.

AMERICAN SURETY COMPANY OF NEW YORK, a corporation,

Petitioner,

vs.

PAUL W. SAMPSELL, as Trustee in Bankruptcy of the Estate of Charles B. Stratton, doing business under the fictitious firm name and styles of Temple City Building Materials Co. and Stratton Construction Co.,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

THOMAS S. TOBIN,
817 Board of Trade Bldg., 111 West Seventh Street,
Los Angeles 14, California,
Counsel for Respondent.

MARTIN GENDEL,
Of Counsel.

Parker & Company, Law Printers, Los Angeles. Phone TR. 5206.

TOPICAL INDEX.

PAGE

Argument 2

I.

There is no legal proposition involved in the decision of the United States Circuit Court of Appeals for the Ninth Circuit which would justify this Honorable Court in hearing the petition for writ of certiorari 2

II.

The judgment of the United States Circuit Court of Appeals is in accord with the decisions of the Supreme Court of the United States 4

Conclusion 8

TABLE OF AUTHORITIES CITED.

CASES.

	PAGE
American Surety Co. of New York v. Westinghouse Electric Mfg. Co., 296 U. S. 133, 56 S. Ct. 9, 80 L. Ed. 105, 29 A. B. R. (N. S.) 655	4
Moise v. Scheibel, 245 Fed. 546	4
Prudence Realization Corp. v. Ferris, 323 U. S. 650, 65 S. Ct. 539, 89 L. Ed. 456	5
Prudence Realization Corp. v. Geist, Trustee, 316 U. S. 89, 62 S. Ct. 978, 48 A. B. R. (N. S.) 695	6
United States v. National Surety Co., 254 U. S. 73, 41 S. Ct. 29, 65 L. Ed. 143	4

TEXTBOOK.

3 Collier's 14th Edition (Bankruptcy), p. 291, par. 57.21	5

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 142.

AMERICAN SURETY COMPANY OF NEW YORK, a corporation,

Petitioner,

vs.

PAUL W. SAMPSELL, as Trustee in Bankruptcy of the Estate of Charles B. Stratton, doing business under the fictitious firm name and styles of Temple City Building Materials Co. and Stratton Construction Co.,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Your respondent respectfully submits, in opposition to the petition for writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit, that hearing of said petition by this Honorable Court should be denied on the following grounds:

I.

THERE IS NO LEGAL PROPOSITION INVOLVED IN THE DECISION OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT WHICH WOULD JUSTIFY THIS HONORABLE COURT IN HEARING THE PETITION FOR WRIT OF CERTIORARI.

II.

THE JUDGMENT OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT IS IN ACCORD WITH THE DECISIONS OF THE SUPREME COURT OF THE UNITED STATES.

ARGUMENT.

I.

There Is No Legal Proposition Involved in the Decision of the United States Circuit Court of Appeals for the Ninth Circuit Which Would Justify This Honorable Court in Hearing the Petition for Writ of Certiorari.

As appears from the wording of the surety bond filed by the petitioner, upon which its original liability is predicated, the petitioner bound itself as surety

> ". . . unto any and all persons, furnishing materials used in, upon, for or about the performance of the work contracted to be executed or performed under the contract hereinafter mentioned, and all persons who performed work or labor upon the same, and all persons who supply both work and materials, and whose claim has not been paid by the contractor, company, or corporation, in the just and full sum of Thirty-Three Thousand Nine Hundred and No/100 ($33,950.00) Dollars, for the payment whereof well and truly to be made, said Principal, and Surety bind themselves, their heirs, adminis-

trators, successors and assigns, jointly and severally, firmly by these presents." [R. 86, 87.]

The authorities and argument presented by petitioner are only to the effect that if certain steps are not taken by claimants under such a bond, ultimately the surety will be able to set up such omissions as a defense in the nature of a plea in abatement to the claims. The Circuit Court of Appeals, in referring to the fact that State law was not involved and the matter was purely one of Federal law [R. 130], was not ignoring the provisions of the State law and of the bond itself, as far as a State suit was concerned, but properly considered the fact that the surety, by filing the bond, assumed an obligation, and the materialmen, by delivering the materials in reliance thereon, became creditors, thereby eliminating the contention of the surety that the claimants were never creditors, merely because they never filed suit against the surety. By analogy, the payee of a promissory note is a creditor of the payee, but the payor may defend a suit if brought after the period set out in the statute of limitations has expired, by pleading the statute. However, the payee still remains a creditor, so far as the creditor-debtor relationship is concerned, until he is paid. Let us assume that such promissory note is secured by a mortgage on realty. While the payor may successfully defend suit on the note if the period of the statute of limitations has expired, he nevertheless remains a debtor of the payee, and the payor may not eliminate the encumbrance created by his note secured by the mortgage, which remains in effect against his property, until the creditor is paid in full; and the debtor is prevented from quieting title to his property until the outlawed obligation is paid, because "he who seeks equity must do equity."

It is contended by the petitioner that the decision in the instant case by the Circuit Court conflicts with a decision of the Eighth Circuit in *Moise v. Scheibel*, 245 Fed. 546 (1917), and that therefore this Court should take jurisdiction to determine the alleged conflict. The pertinent facts of the *Moise v. Scheibel* case are set out in the petition for writ of certiorari at pages 25 and 26, and those facts have no relationship whatsoever to the problem in the instant case, which is predicated upon the settled rule of law that a surety cannot participate in dividends from a bankrupt estate until all creditors of the class, for whose protection the bond of the surety was written, are paid in full. No such issue, and no facts upon which such issue could be predicated, were involved in the case of *Moise v. Scheibel*.

II.

The Judgment of the United States Circuit Court of Appeals Is in Accord With the Decisions of the Supreme Court of the United States.

This Honorable Court has considered similar problems and has held that the participation of a surety in distribution from an estate of a bankrupt is limited by the rule that creditors of the class for the protection of which the bond of the surety was written must first be paid in full, and no distinguishing facts exist in the case at bar which would enable the surety to contend to the contrary.

American Surety Co. of New York v. Westinghouse Electric Mfg. Co. (1935), 296 U. S. 133, 56 S. Ct. 9, 80 L. ed. 105, 29 A. B. R. (N. S.) 655;

United States v. National Surety Co. (1920), 254 U. S. 73, 41 S. Ct. 29, 65 L. ed. 143.

And see the concurring opinion of Chief Justice Stone in

Prudence Realization Corp. v. Ferris (1945), 323 U. S. 650, 65 S. Ct. 539, 89 L. ed 456.

The leading text-book on bankruptcy, Collier's 14th edition, Vol. 3, page 291, Par. 57.21, states as follows:

> "A merely partial discharge of the principal debt by the surety, be it prior or subsequent to the date of the filing of the petition in bankruptcy, falls squarely under Section 57i. This section provides that the surety or other secondary debtor 'shall be subrogated to that extent to the rights of the creditor.' Taken at their face value these words would seem to indicate that the creditor who proved his claim on which the surety made a part payment must share his dividends with the surety. Thus if the claim originally amounted to $1,000 and the surety paid $750 thereon, Section 57i conveys the impression that whatever dividends are paid on the $1,000 claim are to be divided between creditors and surety, one-quarter going to the creditor and three-quarters to the surety. The law, however, is otherwise. It allows the original creditor to continue collecting dividends on the *entire* amount of the claim ($1,000 in the previous illustration), until the aggregate of the surety's part payment and the dividends amount to one hundred per cent of the claim. Then only may the surety assert his right to further dividends based on that part of the original claim to which he was subrogated ($750). Whatever the creditor receives in excess of the principal and interest remaining due him is held by him in trust for the surety. In this respect there is no difference between a surety who is secondarily liable for the full amount of the principal debt and one who limited his liability to a certain maximum

(smaller than the principal debt) which he paid in full. Both have to wait until the principal creditor is fully satisfied."

In support of the above proposition the text cites some seven or eight cases as being among the leading cases sustaining the position taken by the Referee and the Ninth Circuit Court of Appeals in the case at bar.

These authorities and the reasoning above set out are confirmed by this Honorable Court in the case of

Prudence Realization Corp. v. Geist, Trustee (1942), 316 U. S. 89, 62 S. Ct. 978, 48 A. B. R. (N. S.) 695;

In that case the Court found that the written arrangement between the parties was different from the usual surety arrangement as found in the case at bar, but in discussing the law applicable to the problem, reaffirmed the contention of the respondent that the surety is not entitled to dividends on its claim until the class of creditors protected by its bond are paid in full.

In the cited case this Honorable Court states (p. 95):

". . . The Bankruptcy Act describes its own criteria for distribution to creditors. In the interpretation and application of federal statutes, federal and not local law applies . . . The court of bankruptcy is a court of equity to which the judicial administration of the bankrupt's estate is committed, . . . and it is for that court—not without appropriate regard for rights acquired under rules of state law—to define and apply federal law in determining the extent to which the inequitable conduct of a claimant in acquiring or asserting his claim in bankruptcy requires its subordination to other claims which, in other respects, are of the same class . . ."

In the case at bar the filing of the bond and the delivery of the materials created a creditor and debtor relationship between the surety and the materialmen. The obligations to the creditors as described in the Statement of Facts, were not paid. Therefore, there is no question of State law, but a question of subordination of claims, and the equitable powers of the bankruptcy court were properly exercised in this case, although the petitioner criticizes the Trustee and the Referee in Bankruptcy for exerting efforts which petitioner asserts were for the protection of creditors who were not otherwise diligent on their own behalf. After all, the defense of failure to file mechanics' or materialmen's liens or to file suit to foreclose liens, is not a defense going to the merits of a claim, and petitioner herein is not in any moral or equitable position to assert that it has been harmed by the rulings of the court below with reference to this surety bond filed to protect the materialmen. The claims of such materialmen rightfully are recognized as being entitled to participate in dividends to the full extent of such claims before any participation by the surety in the distribution of the bankrupt estate, since such claimants delivered materials and labor to the job and aided in its completion, which enabled the bankrupt estate to realize therefrom moneys for dividend distribution, thereby lessening the liability of the surety to the claimants. True, the surety has paid out money in discharging a claim against the bankrupt, but, as a surety, it stood in the shoes of the bankrupt to the extent it was obligated to pay these claims. The surety's obligation was supported by a consideration, and, in many instances, as in this case, security is required of a principal in addition to the premium exacted. Toward the class of creditors covered by the bond, the bankrupt and

the surety stood shoulder to shoulder. The surety is charged with knowledge of the law as declared by this Court.

It is to be noted that the petition for writ of certiorari is not accompanied by the usual certificate of counsel that in his opinion it is meritorious and not interposed for delay.

Conclusion.

Wherefore, it is respectfully submitted that there is no basis for the granting of the writ of certiorari, and that this Honorable Court should refuse to review the decision of the United States Circuit Court of Appeals for the Ninth Circuit.

July, 1945.

THOMAS S. TOBIN,
111 West Seventh Street, Los Angeles 14,
Counsel for Respondent.

MARTIN GENDEL,
Of Counsel.